

Share Option Plans Worthless

Almost three quarters of employee share options plans issued by the top 50 ASX-listed companies since 2003 are now worthless, research by the law firm Deacons has found.

For the companies listed in the bottom two-thirds of the S&P/ASX 300 Index, almost 90 per cent of the plans are worthless.

Executives at major listed companies including Macquarie Group, Toll Holdings, Tabcorp and Babcock & Brown are just some of those who have watched millions of dollars in share options disappear after the All Ordinaries had its worst calendar year on record in 2008, plummeting 43 per cent.

Yesterday, the share market fell to its lowest point this year, with the S&P/ASX 200 Index losing another 5.2% for the year.

Employee share option schemes have been embraced over recent years, especially by smaller listed companies trying to compete with their higher-paying rivals in the battle for executive talent.

The plans set the share price at which executives can take up the options and usually vest three years after being issued.

The schemes delivered big windfalls at the height of the boom, with options often being exercised at a fraction of the company's rising share price. But most of the windfalls executives thought they had pocketed have evaporated.

Executives at Macquarie Group and Toll Holdings have been hit particularly hard because they are the only two companies in the top 50 which exclusively use option plans, rather than performance rights plans.

"Performance rights plans provide at least some protection from sharp market falls because they have a nil exercise price and the performance hurdle usually involves comparing the company's total shareholder return against a group of similar companies," said Andrew Spalding and Shane Bilardi, authors of the research undertaken last month.

"Provided that the company matches or outperforms its peers, the rights can still vest even in a falling market."

The average exercise price for Macquarie options is \$61.23, the company's most recent annual report shows. At current levels, its share price would need to more than double before the option plans regain any value for executives.

Tabcorp options would also need to more than double, being on average 54 per cent out of the money.

Timbercorp's share price would need to increase 13 times, with options on average 92.5 per cent out of the money.

Fortunately for executives at the blue chips, many ASX top 50 companies have moved exclusively to performance rights plans or use them in a combination with option plans.

"It seems most of the top 50 companies have learnt a lesson from the Dotcom crash and moved to performance rights schemes rather than employee option schemes to ensure that their incentive schemes continue to motivate their employees during downturns in the market," the authors said. "The same cannot be said for many companies outside the top 100, and this could have an adverse impact

on their ability to retain and motivate their key employees."

The exercise prices of options issued under the plans of the top 50 listed companies are on average 4 per cent above their current share price. But even that result is flattering because of the strong performances of QBE, Woolworths, Fortescue Metals and Origin Energy and the fact that the worst performers – Asciano, Centro and Babcock – have dropped out of the top 50.

The exercise prices of options issued under the plans of the companies in the bottom two thirds of the top 300 are on average 49 per cent above their share prices.

Remuneration Strategies Group director Gary Fitton said that any gearing plans put in place before the crash were simply outdated.

"Companies tend to adopt a fairly copycat approach and some investors are now asking whether different performance hurdles should be used, given the historically low watermark for the market.

"You may see more internal performance measures being adopted and a return to more earnings orientated measures."

Patrick Durkin
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